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IN THE

Supreme Court of the United States

October Term, 1962

No. 341

H. L. DILLON, JR., ET AL., *Petitioners*

v.

MICHEL T. HALBOUTY, ET AL., *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF TEXAS

Brief of Respondents Michel T. Halbouty and Meredith & Company in Opposition

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Michel T. Halbouty and Meredith & Company, two of the Respondents in the above-entitled cause, respectfully submit this Brief in Opposition to the Petition for Writ of Certiorari filed herein by Petitioners.

Opinions Below

The opinion of the Supreme Court in this case is correctly identified in the Petition and is copied in Appendix

"A" to the Petition. Likewise, the dissenting opinion of Associate Justice Smith on rehearing is correctly identified in the Petition and copied in Appendix "B" thereto. In addition, the Petition contains a copy of the opinion of the Court of Civil Appeals in the case of *Halbouty v. Darsey* (Appendix "C" of Petition), and contains a statement that the case of *Halbouty v. Darsey* is a "companion case". (Petition p. 2) Respondents deny that the present case and the case of *Halbouty v. Darsey* are "companion cases". Each was an entirely separate and distinct proceeding growing out of different facts and in fact involving different parties. Neither Respondents Henderson, nor Meredith & Company were parties to the case of *Halbouty v. Darsey*, and there was no jurisdictional or judicial connection between the two cases. *Halbouty v. Darsey* involved the validity of a Rule 37 permit issued by the Railroad Commission of Texas, and the instant case involves the ultimate determination of the validity of a proration order issued by the Railroad Commission of Texas.

Jurisdiction

These Respondents submit that this Honorable Court has no jurisdiction to review the judgment of the Supreme Court of Texas in this cause, because that judgment in no way limits or restricts production from Petitioners' wells nor deprives them of any rights or property whatever. The only effect of the judgment was to declare invalid the 1/3-2/3 allocation formula adopted by the Railroad Commission of Texas, because it did not afford Respondents an opportunity to produce their fair share of the gas in the Port Acres Field reservoir. Unless the Railroad Commission of Texas has established a valid allocation formula to govern allowable production from wells

in a given field, Statewide Rule 25 becomes the applicable rule controlling allowable production from wells located in such field. Statewide Rule 25 permits wells to produce daily up to 25% of their open flow potential. It reads:

> "RULE 25. PRODUCTION OF GAS TO BE RESTRAINED TO TWENTY-FIVE PER CENT OF POTENTIAL CAPACITY.—When the gas from any well is being used, the flow or production thereof shall be restrained to twenty-five per cent (25%) of the potential capacity of the same; that is to say, in any day (24 hours) the well shall not be permitted to flow or produce more than one-quarter of the potential capacity thereof as shown by the determination of potential provided for in Rule 24 hereof; provided, that this rule shall not apply to casinghead gas, and provided further, that in cases of emergency, greater production may be used, after special authority therefor has been secured from the Railroad Commission of Texas. Applications for exceptions to this rule must be made to the Railroad Commission within thirty (30) days after effective date of this order. Where more than twenty-five per cent (25%) of the potential capacity is now being used, and thirty days from date will be given to secure permits for such special authority for exceptions to the rule."

The open flow potentials of all of Petitioners' wells are reflected in Plaintiffs' Exhibit No. 32 (S.F. page 308; Exhibit Vol. VI), and their allowables under the invalid 1/3-2/3 allocation formula are also shown in Plaintiffs' Exhibit 13 (S.F. page 18; Exhibit Vol. II). By a simple mathematical calculation it becomes obvious that Petitioners are in no way injured as a result of the 1/3-2/3 allocation formula having been invalidated by the judgment of the Texas Supreme Court. Rather, until such time as the Texas Railroad Commission enters a valid new

allocation order, Petitioners are freed from the restrictions imposed by the 1/3-2/3 formula, and are permitted to produce the increased amount provided by Rule 25.

Furthermore, this Court has laid to rest any question about its taking jurisdiction of disputes relating to the validity or invalidity of allocation formulas established by the Texas Railroad Commission pursuant to the applicable State statutes in the two *Rowan and Nichols Oil Company* cases. In the case of *Railroad Commission of Texas v. Rowan and Nichols Oil Company*, 310 U.S. 573, this Court said:

> "* * * What ought not to be done by the Federal courts when the due process clause is invoked ought not to be attempted by these courts under the guise of enforcing a state statute. Whether the respondent may still have a remedy in the state court is for the Texas courts to determine, and is not foreclosed by the denial, on the grounds we have indicated, of the extraordinary relief of an injunction in the federal courts."

Also, in *Railroad Commission of Texas v. Rowan and Nichols Oil Company*, 311 U.S. 578, it was held:

> "The court below also erred in holding the order a violation of the Texas statute requiring proration on a 'reasonable basis.' Vernon's Texas Annotated Civil Statutes, art. 6049c, Section 7. In denying the petition for rehearing in the earlier cases we held that whatever rights the state statutes may afford are to be pursued in the state courts."

The Supreme Court of Texas, in its opinion in this case, has held that the 1/3-2/3 allocation formula rule estab-

lished by the Texas Railroad Commission does not comply nor conform to the standards established by the Texas Legislature in Sections 12 and 13 of Article 6008, *Vernon's Annotated Texas Civil Statutes*. (Appendix "E" to Petition, pp. 77-78). In so holding, it has not in any sense of the word deprived Petitioners of their rights or their property in violation of the Constitution of the United States.

Statement of the Case

These Respondents do not agree with the Statement of the Case as set out in the Petition. We do agree that the case involves the question of correlative rights between the operators of standard size proration units on the one hand and the Rule 37, or small tract operators on the other. The Texas Supreme Court did reverse and render the judgment of the trial court which had sustained the gas proration order of the Texas Railroad Commission. The only question presented to the Texas Supreme Court was whether or not that gas proration Order was valid. It held the Railroad Commission Order invalid because it was not supported by substantial evidence, but on the contrary was arbitrary, unreasonable and confiscatory of Respondents' property. (Appendix "A" to Petition, p. 32)

Petitioners would have this Court believe that the Texas Supreme Court based its holding on a bill of exception relating to offers which had been made to the small tract operators to pool their lands with properties belonging to the operators of the regular sized units. This, we submit, is an inaccurate appraisel of the opinion. A mere reading of the opinion of the Supreme Court of Texas discloses that the Court held that the allocation formula under attack was invalid because it did not afford Respondents (the plaintiffs in that case) an opportunity to produce

their "fair share of the gas to be produced from the reservoir" in accordance with Article 6008, Section 12, *Vernon's Annotated Texas Civil Statutes*, supra. This holding was based primarily on a consideration of the small tract operators' own evidence, which reflected that under the Order, more than 90% of the hydrocarbons recovered by the small tract wells would be drained from other leases in the field, and that such a formula did not come close to compelling ratable production nor afford to each producer in the field an opportunity to produce his fair share of the gas from the reservoir. (Appendix "A" to Petition, p. 46)

On August 18, 1958, the Railroad Commission issued its Special Order No. 3-38,395 prescribing field rules for the Port Acres Field, one of which rules was Rule 3 establishing an allocation formula distributing 1/3 of the total allowed gas production equally between all of the wells in the field and 2/3 of the total allowable gas production between the wells in the proportion that the surface acreage assigned to each such well bears to the total surface acreage in the reservoir. (Appendix "E" to Petition, p. 81) On November 21, 1958, before any town lot wells were drilled, Peter Henderson Oil Company filed an application with the Commission for an amendment of the allocation formula prescribed in Rule 3 of the Field Rules (S.F.; Plaintiffs' Exhibit 2, Exhibit Vol. II). The issues were thus joined at that time, but in spite of this fact, Petitioners began drilling their wells with the knowledge that an amendment of Rule 3 was being sought and continued to drill until at the time of the trial twenty-two town lot wells had been drilled in the Port Acres Field. (Appendix "A" to Petition, p. 31) After the hearing of the application, the Railroad Commission denied any relief to Respondents (Plaintiffs' Exhibit 8, Exhibit Vol. II) with the result that the 1/3—2/3

allocation formula continued to provide the basis for the allocation of gas production from the Port Acres Field. Respondents then filed suit in the District Court of Travis County to set aside the Order of the Railroad Commission establishing the 1/3-2/3 formula as well as the Order denying Respondents' application for an amendment to the formula. In spite of the fact that Petitioners' own evidence upon trial of this case showed that the 22 small tracts on which wells had been drilled in the Port Acres Field contained only 1.77% of the total field reserves, and that under the 1/3-2/3 allocation formula, those 22 small tract wells would recover 20.46% of the field's total gas and condensate reserves (Dillon Exhibits 17 and 21, Exhibit Vol. V), the trial court held that the Order of the Railroad Commission was supported by substantial evidence and entered judgment in favor of Petitioners. (Appendix "F" to Petition, p. 82)

Upon direct appeal of this case to the Texas Supreme Court, that court, basing its judgment largely on the evidence presented to the trial court by Petitioners, concluded that the order of the Railroad Commission was not supported by substantial evidence, but on the other hand was arbitrary, unreasonable and confiscatory as to Respondents, because it did not afford Respondents an opportunity to recover their fair share of the gas and condensate in the Port Acres reservoir as required by Section 12 of Article 6008, *Revised Civil Statutes of Texas*, supra.

ARGUMENT

I.

The Decision Below Is Clearly Correct.

The Petition is based largely upon the lifting of one paragraph out of the exhaustive opinion written by the

Supreme Court of Texas in this case, the omission of which would have had absolutely no effect on the judgment of that Court. Despite the fact that before any of Petitioners drilled a well in the Port Acres Field, an application had been filed with the Railroad Commission to change the allocation formula that had been established for the field, and despite the further fact that an appeal from this denial was being vigorously prosecuted in the courts, Petitioners continued drilling wells in the face of the possibility that this allocation formula would be declared invalid. Alarmed by the decision of the Supreme Court of Texas in the case of *Atlantic Refining Company v. Railroad Commission*, —Tex.—, 346 S.W. 2d 801 (hereinafter referred to as "Normanna"), they argued in this case that if the 1/3-2/3 formula should be held invalid, they would suffer heavy financial loss because of the wells they had previously drilled. It was in passing reference to that contention that the paragraph made the basis of this Petition was placed in the opinion written by the Supreme Court of Texas.

It is true that during the hearing before the Railroad Commission of Texas offers were made to each of Petitioners to pool their tracts with large unit tracts in the Port Acres Field. Evidence of these offers was offered in the trial court and was excluded by that court except for the purpose of the bill of exception. Of course the Supreme Court became aware of this offer in studying the record of this case, but the mere fact that this offer to unitize appeared in the record by bill of exception and was alluded to by the Supreme Court in one paragraph of its opinion, is certainly no indication that the Supreme Court based its decision on a consideration of thos. offers. The mere fact that Petitioners drilled their wells at their own risk in the face of pending litigation and in the face of

offers to pool had no bearing whatsoever on the judgment of the Supreme Court that the Order complained of was invalid. That Order was invalid, as stated by the Supreme Court, because it permitted Petitioners to drain in excess of 90% of the production from their wells from lands belonging to Respondents and because it did not afford to Respondents an opportunity to produce a fair share of the gas and condensate from the reservoir.

II.

There Is No Federal Question Presented

(A) On Page 12 of the Petition, Petitioners contend that the Texas Supreme Court has denied the Petitioners due proces of law by refusing to remand the case for a new trial to permit them to present evidence on an issue considered by the Supreme Court to be material in determining the amount of production which the Railroad Commission of Texas could lawfully assign to Petitioners. With respect to this question, Respondents emphasize that *the only issue* in this case is the validity of the Order establishing the 1/3-2/3 formula in the Port Acres Field. All the Supreme Court of Texas has written in this case is related directly to that issue. Respondents submit that no issue relating to pooling or unitization was raised in the trial court nor in the Texas Supreme Court. If any town lot operator was denied an opportunity to pool or unitize, or was compelled to drill in order to produce the oil or gas underlying his property, the opinion of the Supreme Court of Texas fully protects his right so to prove *before the Railroad Commission* in connection with a new order to be issued by that Commission. The question of foreclosure of the power and authority of the Commission to grant

an exception in such an instance is carefully preserved by the Supreme Court with the Statement that "No such problem is before us.". The Railroad Commission is the initial fact finding agency, and its original jurisdiction to grant or deny exceptions or special allowables is exclusive. Only after the Railroad Commission has acted, and when its orders are being reviewed in appropriate proceedings, would testimony of the kind Petitioners want to offer become material. The prerogative of the Railroad Commission to issue other and valid orders after one of its orders has been held to be invalid was succinctly stated by the Supreme Court of Texas in the case of *Marrs v. Railroad Commission*, 142 Tex. 293, 177 S.W. 2d 941, as follows:

> "The orders heretofore entered will be held to be illegal; and, of course, the Commission will have to enter substantially different orders which will not arbitrarily discriminate between the parties and will not unlawfully deprive petitioners of their property. But within such limitations, the Commission will be left free to prescribe the terms of the orders to be entered by it."

Petitioners cite the case of *Saunders v. Shaw*, 244 U.S. 317, in support of their claim that the Texas Supreme Court has denied to them due process of law in violation of the Fourteenth Amendment to the United States Constitution. Respondents submit that the *Shaw* case offers no comfort to Petitioners. In that case the State Supreme Court, basing its judgment on the very evidence that had been held inadmissible in the trial court, reversed the judgment of the trial court and granted an injunction. Respondents submit that there is no similarity between the

Shaw case and this case. The Texas Supreme Court did not, in its judgment or in its opinion, pass upon the admissibility nor deem material the offers to unitize which were held inadmissible by the trial court. Whether or not offers to unitize had been made to Petitioners would not have made the allocation formula fair and reasonable as to Respondents. That Order denied to Respondents the right to produce their fair share of the gas and condensate in the Port Acres Field and the passing reference by the Supreme Court to the fact that the investments of Petitioners in their wells would have been avoided and they could have recovered a fair share of the minerals produced from the common source had they accepted certain offers of unitization does not change that crucial issue.

(B) At pages 14 and 19 of the Petition, Petitioners contend in effect that the judgment of the Texas Supreme Court requires the Railroad Commission of Texas, as a matter of law, to place stringent limitations upon the production by Petitioners of gas from wells on their leases, depending on whether or not they were offered unitization that would prevent confiscation and afford them a fair share of the mineral proceeds from the common source, but that the Texas Supreme Court does not point out any statutory procedure or reasonably definite or ascertainable standard by which the Railroad Commission may be guided. In making these contentions, Petitioners miss the real issue in this case and ignore certain vital statements contained in the opinion of the Supreme Court of Texas. As pointed out above, until such time as the Railroad Commission issues a new order relating to the allocation of production from the Port Acres Field, the Petitioners have been released from the fieldwide allocation formula

and are free to produce their wells under Statewide Rule 25. That is the effect of the judgment of the Texas Supreme Court on Petitioners. Whatever limitation, if any, were to be placed by the Railroad Commission on the production of Petitioners' wells was very clearly reserved to the Railroad Commission by the Texas Supreme Court in its opinion:

> "We fully appreciate the thorny problem that the Commission has in this matter of proration among the hundreds of fields under their supervision with different characteristics and the diverse conflicting interests, views and opinions but we are confident that with the trained personnel at their disposal a much nearer approximation can be made, giving to all parties an opportunity to produce a fair share of the minerals underlying the field with ratable allowables that will be more nearly equitable than appears in the case before us. As long ago as 1935 we said in the Brown v. Humble Oil & Refining Company case:
>
> > "* * * It is now, however, recognized that when an oil field has been fairly tested and developed, experts can determine approximately the amount of oil and gas in place in a common pool, and can also equitably determine the amount of oil and gas recoverable by the owner of each tract of land under certain operating conditions.'"

Previously, the Supreme Court of Texas had reserved the rule making power to the Railroad Commission in the case of *Corzelius v. Harrell*, 143 Tex. 508, 186 S.W. 2d 961, at Page 967, as follows:

> "The Railroad Commission is not required in administering the oil and gas statutes to be absoluetly

accurate in its rules and orders. This would be impossible. It is the duty of the Commission to treat all interested parties justly and impartially, and the actions and rulings of the Commission in attempting to accomplish such results will not be disturbed by the courts unless such rules or orders are clearly illegal, unreasonable or arbitrary. *The power to make rules rests exclusively with the Railroad Commission. Courts may adjudge that a rule of the Commission is invalid, but they can not substitute a new rule for the one adjudged invalid. Brown v. Humble Oil & Refining Co.*, 126 Tex. 296, 83 S.W. 2d 935, 87 S.W. 2d 1069, 99 A.L.R. 1107; 1D, 126 Tex. 296, 87 S.W. 2d 1069, 101 A.L.R. 1393; *Gulf Land Co. v. Atlantic Refining Co.*, 134 Tex. 59, 131 S.W. 2d 73; *Magnolia Petroleum Co. v. Railroad Commission*, 128 Tex. 189, 96 S.W. 2d 273; *Magnolia Petroleum Co. v. New Process Production Co.*, 129 Tex. 617, 104 S.W. 2d 1106; *Railroad Commission v. Wencker*, 140 Tex. 527, 168 S.W. 2d 625." (Emphasis supplied)

The Supreme Court of Texas has not held in this case that in making valid rules and regulations governing allowable production from the Port Acres Field the Railroad Commission must take into consideration offers to pool or unitize. The only standards referred to by the Court were those which had been established by the Legislature of the State of Texas and which had previously been construed by that court. The Court defined the rights of the owners of oil and gas properties in Texas and generally referred to the standards by which the Railroad Commission should protect those rights as follows:

"In Marrs v. Railroad Commission, 142 Tex. 293, 177 S.W. 2d 941, we held that 'Under the settled law of this State oil and gas form a part and parcel

> of the land wherein they tarry and belong to the owner of such land or his assigns; and such owner has the right to mine such minerals subject to the conservations laws of this State. Every owner or lessee is entitled to a fair chance to recover the oil or gas in or under his land, or their equivalent in kind, and any denial of such fair chance amounts to confiscation.'
>
> "As pointed out in Normanna we also held in the Marrs case that the allowables fixed for the two separate areas were entirely out of proportion to the potentials and would result in the taking of one man's property and giving it to another. Although the Marrs case rejected the substantial evidence rule, nevertheless that is not to say that the rules of law otherwise announced by that decision are wrong or have been overruled by later decisions of this court."

The rights enunciated in the above-quoted paragraph from the opinion of the Supreme Court of Texas were not qualified by that court as being dependent upon offers to pool or unitize. Neither was the Railroad Commission enjoined to consider such offers in connection with its exclusive rule making power.

(C) At page 20 of the Petition, in Paragraph 4, Petitioners advance a proposition that Respondents submit is entirely novel, and which has not heretofore been recognized in the regulation by the State of Texas (or any other state) of the oil and gas industry. That proposition, briefly stated, is that a permit to drill an oil and gas well is akin to a public utility franchise, and, when granted, the Railroad Commission must grant a production allowable that will afford to the holder of the permit a return on his investment that will enable him to recover his drilling cost, operating expenses, and a reasonable profit.

Certainly the oil and gas industry would be pleased with a guaranteed rate of return on its investment; but this is not the law and the cases cited by Petitioners do not so hold. The first case cited by Petitioners, *Halbouty v. Darsey*, 326 S.W. 2d 528 (Tex. Civ. App., writ ref'd, n.r.e.), has the following to say as to Rule 37 permits:

> "Exceptions to the rule, granted to protect vested rights, for which the rule expressly provides presuppose some resultant waste, or other detriment. The inherent right of the landowner to obtain his fair share of the oil in place under his land is the basic consideration for the exception to the rule 'to protect vested rights,' which is deemed to outweigh other considerations for which the rule was promulgated. *The commission has ample power to pass such rules or orders as may be necessary to minimize the deleterious effects flowing from exceptions to the rule.*" (Emphasis supplied)

The case of *Humble Oil & Refining Company v. Railroad Commission*, 94 S.W. 2d 1197 (Tex. Civ. App., writ of err. ref'd) also fails to support Petitioners' position. That case merely held that in determining whether a segregated tract was entitled to a permit to drill a well as an exception to Rule 37 of the Rules of the Railroad Commission of Texas, the Rule, as it existed at the time of the segregation, should be controlling and not a subsequent amendment to that Rule. The case made no attempt to draw a parallel between franchises granted to public utilities and permits to drill oil and gas wells under regulations of the Railroad Commission of Texas. The case of *Humble Oil & Refining Company v. C. C. Cook, et al.*, 215 S.W. 2d 383 (Tex. Civ. App., writ ref'd, n.r.e.) likewise drew no analogy between well drilling permits and franchises

granted to public utility companies. That case did state that a "permit carries with it the right, in the event of production, *to operate the well and to produce the oil or gas under the rules and regulations of the Railroad Commission.*" (Emphasis supplied) Petitioners imply that the operator of a well drilled under a Rule 37 permit acquires a vested right to produce the same amount of oil or gas during the life of such well as was fixed by the proration schedule in force at the time he drilled such well. The reverse of this is true and was held in Texas in the case of *Chenoweth v. Railroad Commission*, 184 S.W. 2d 711 (err. ref'd). In that case the court held:

> "* * * It is settled law that when an owner or operator invests his money and drills a well in keeping with an existing valid order of the Commission he acquires property rights which he is entitled to have protected. The most common instance in such cases is where an owner has drilled his tract to a density authorized by the old oil spacing provisions of 150-300 feet. Change of the spacings to 330-660 feet cannot operate to destroy his property rights legally acquired in the wells already drilled under the former spacing provisions. *But such owner or operator acquires no vested right to continue to produce the same amount of oil or gas during the life of such well as was fixed by the proration schedule in force at the time he drilled such well.*" (Emphasis supplied)

The other cases cited by Petitioners under this proposition are strictly public utility cases involving railroads, electric companies and other public utilities which are, of course, affected with a public interest. Respondents submit that these cases have no application to this case and are in no way analogous.

Conclusion

At page 22 of the Petition, Petitioners admit that the decision of the majority of the Texas Supreme Court is final on matters within the State's exclusive control and jurisdiction and that this court will not concern itself with the correctness of the construction of Texas statutes by the Texas Supreme Court. Respondents respectfully submit that this case falls precisely within the boundaries of that admission. The interjection of mere possibilities as to the type of rule which will be entered by the Railroad Commission of Texas on further hearing cannot convert a correct decision into an important question of federal law warranting review by this court on certiorari.

WHEREFORE, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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I, Harry R. Jones, attorney for Respondents, Michel T. Halbouty and Meredith & Company, depose and say that I have served copies of the foregoing Brief in Opposition to Petition for a Writ of Certiorari, by mailing the same by United States mail, certified mail, return receipt requested, to the following counsel of record in said cause:

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SUBSCRIBED AND SWORN to before me on this the 15 day of September, A.D., 1962.

Notary Public in and for
Harris County, Texas

FEROL ROGERS
Notary Public, in and for Harris County, Texas